Information from the Division of Health Care Finance and Policy

FY05 Annual Acute Hospital Financial Report

The financial health of the hospital industry showed significant improvement in FY05. Overall profitability improved across the industry. Hospitals also demonstrated sustained improvements in liquidity, with a majority of hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remained a serious concern for one-third of Massachusetts hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly and annual acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to better protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis of audited data from FY01 through FY05.[1] Financial trends for individual hospitals are on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly and annual basis are profitability, liquidity, and solvency.[2]

Profitability

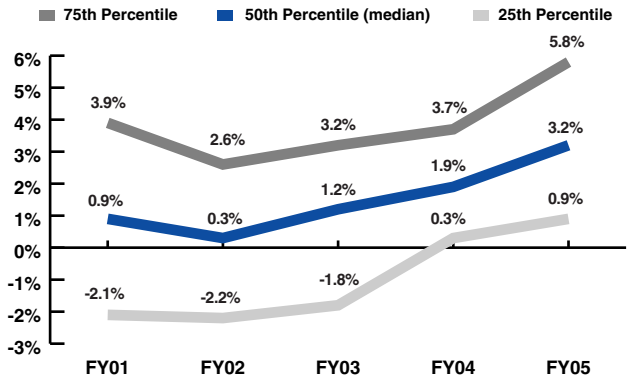
Although most Massachusetts acute care hospitals are non-profit, they do need to generate a sufficient surplus in order to complete their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY01 through FY05 trends for 25th, 50th (median) and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

Total profitability improved significantly for all three quartiles in FY05 compared to FY04, with 80% of hospitals experiencing positive total margins (up slightly from 79% in FY04). Operating Margins also improved across all quartiles, with 71% (versus 58% in FY04) reporting operating gains, and 29% (versus 42% in FY04) reporting operating losses. Non-operating Margins also improved across all three quartiles, with 95% of hospitals (versus 88% in FY04) experiencing non-operating gains, and only 5% (versus 12% in FY04) experiencing non-operating losses..

Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indica-

Figure 1
Total Margin Trend, FY01-FY05



- **Overall profitability improved across all three quartiles in FY05, with 80% of hospitals experiencing total gains, and 20% experiencing total losses.**

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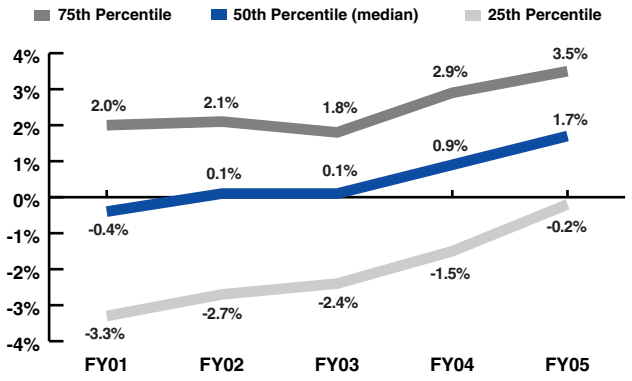
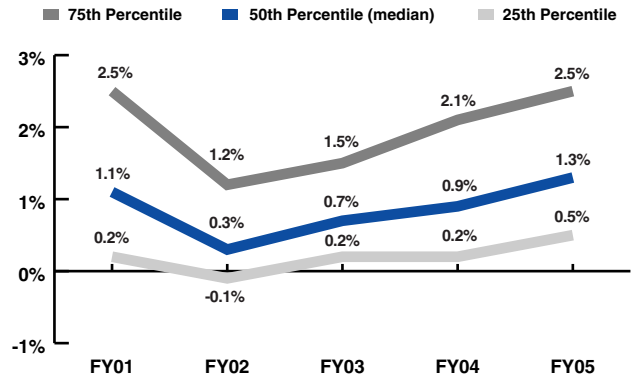
Figure 2
Operating Margin Trend, FY01-FY05



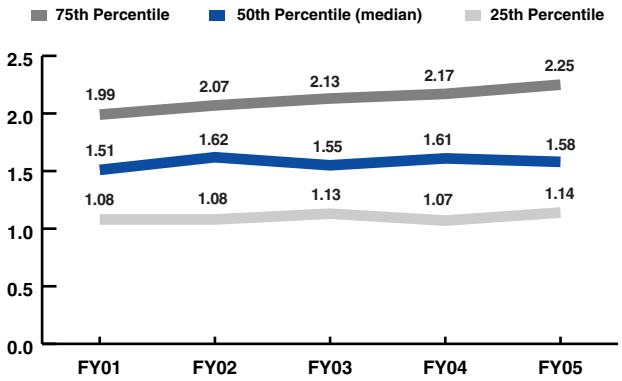
- **Operating performance continued to improve across the industry in FY05, with 71% of hospitals experiencing operating gains and 29% experiencing operating losses.**

Figure 3
Non-operating Margin Trend, FY01-FY05



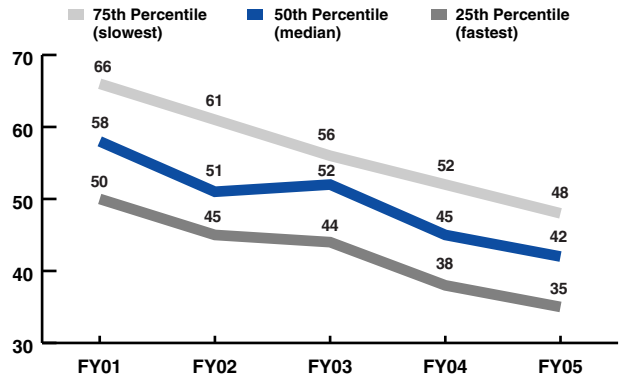
- **Non-operating Margin improved across all quartiles in FY05, with 95% of hospitals experiencing non-operating gains and 5% experiencing non-operating losses.**

Figure 4
Current Ratio Trend, FY01-FY05



- **Current Ratio improved for the upper and lower quartiles, and decreased slightly for the middle quartile. A majority of hospitals (86%) continued to maintain Current Ratios above the 1.0 benchmark in FY05.**

Figure 5
Days in Accounts Receivable Trend, FY01-FY05



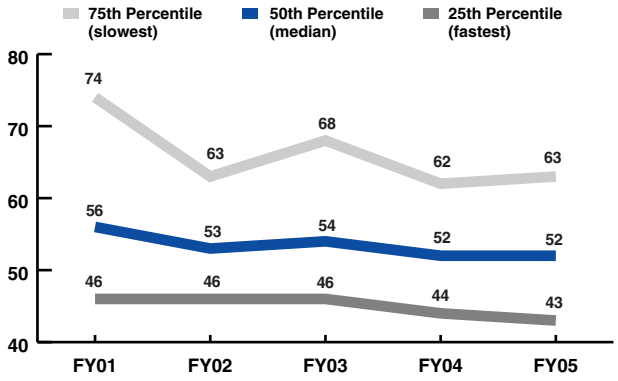
- **Continuing the industry's positive trend since FY01, hospitals again improved collection of receivables in FY05, with decreases across all three quartiles. Median Days in Accounts Receivable decreased by three days.**

tion of financial stress. Three liquidity ratios are reported here: Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period.[9] Figures 4, 5, and 6 show trends in quartile values for these three ratios.

The majority of hospitals demonstrated favorable short-term liquidity in FY05. The upper and lower quartiles showed improvement in Current Ratio. Although the middle quartile decreased slightly, these values remained above the industry benchmark (see Figure 4).[10] In addition, the industry showed more efficient management of Days in A/R (see Figure 5) and stability in the average time to pay current liabilities (Average Payment Period, see Figure 6) across all quartiles.

Figure 6

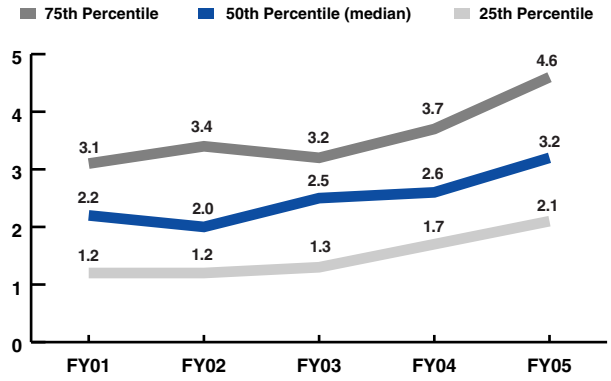
Average Payment Period Trend in Days, FY01-FY05



- **Average Payment Period increased by one day in the upper quartile, remained stable in the middle quartile, and decreased by one day in the lower quartile.**

Figure 7

Debt Service Coverage Total Trend, FY01-FY05



- **Debt Service Coverage improved across all quartiles in FY05.**

Solvency

Solvency ratios provide information regarding both how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. Three solvency ratios are reported: Debt Service Coverage[11], Cash Flow to Total Debt[12], and Equity Financing.[13] Figures 7, 8, and 9 show trends in quartile values for these three ratios.

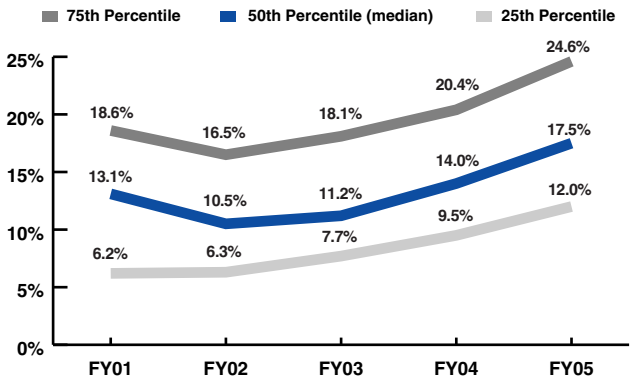
Debt Service Coverage, which measures the ability to meet principal and interest payments in the upcoming year, improved for the entire industry in FY05. All but two hospitals showed positive ratios, and all quartiles remained above the 1.5 benchmark. Further, only nine hospitals (versus 12 in FY04) exhibited Debt Service Coverage ratios below the 1.5 benchmark (see Figure 7).

Cash Flow to Total Debt is the measure of a hospital's percentage of cash flow to current and long term debt obligations and a known indicator of future financial distress and insolvency. This solvency indicator improved across all quartiles in FY05 versus FY04 (see Figure 8). Improvements were largely attributable to enhanced overall profitability for the industry.

The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the ability of a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition. Equity Financing remained fairly constant in FY05 compared to FY04. Close to 68% of the industry was above the 30% benchmark, and long term solvency remained favorable for this group; however, this ratio was below the 30% industry benchmark for the other 32% of the hospitals, indicating potential long-term solvency issues for this group (see Figure 9).

Figure 8

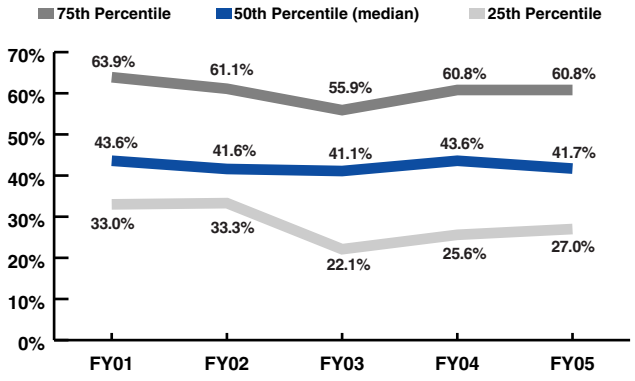
Cash Flow to Total Debt Trend, FY01-FY05



- **Cash Flow to Total Debt improved substantially across the industry in FY05. Improvements were largely due to enhanced profitability for the industry.**

Figure 9

Equity Financing Trend, FY01-FY05



- **Equity Financing Ratios remained fairly stable in FY05. However, just under one-third of the hospitals were below the 30% benchmark and the highly leveraged position of these hospitals may make future asset acquisition difficult for this group.**

Teaching versus Non-teaching Hospitals

The Division of Health Care Finance and Policy also examines the financial health of teaching versus non-teaching hospitals using financial ratio analysis. Overall, teaching hospitals outperformed non-teaching hospitals across the three quartiles in terms of profit levels, and a higher percentage of teaching hospitals (88%) versus non-teaching hospitals (78%) generated a total surplus. In terms of operating margin, teaching hospitals again showed higher levels of performance across the three quartiles; however, a higher percentage of non-teaching hospitals (72%) versus teaching hospitals (69%) showed an operating surplus in FY05. Only one teaching and two non-teaching hospitals showed a negative non-operating margin

Results between the two groups were mixed with regard to liquidity. On average, Current Ratio was higher for teaching hospitals; however, a higher percentage (88%) of non-teaching hospitals had Current Ratios above the minimum industry benchmark of 1.0 (compared to 81% of teaching hospitals). In terms of collecting receivables due, the results were mixed depending on the quartile; however, non-teaching hospitals were quicker at paying current obligations across all three quartiles.

In terms of solvency, teaching hospitals are generally stronger. A slightly higher percentage of non-teaching hospitals—14% versus 13% for teaching hospitals—will have more difficulty meeting interest and principal payments in the upcoming year. In addition, teaching hospitals performed better in terms of repaying current and non-current debt, for the most part, and were substantially less leveraged as 75% (versus 66% of non-teaching hospitals) were above the 30% benchmark for Equity Financing.

Summary

The majority of hospitals reported improved overall profitability in FY05, with 80% experiencing total gains and only 20% of the industry experiencing total losses. Overall, the industry demonstrated improved liquidity, with a majority of hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remained a serious concern for one-third of Massachusetts hospitals.

Financial ratios for each hospital are on the Hospital Fact Sheets in the DHCFP Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

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[1] The findings in this report are based on the financial filings of 65 acute care hospitals. One hospital–Quincy Medical Center–did not submit its filing in time to be included in this report. Due to the Vanguard purchase of MetroWest and Saint Vincent's hospitals, the fiscal year filings submitted represent six months of operation.

[2] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[3] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the low end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the high end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median, or the center of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[4] Ratio of total income to total revenue.

[5] Ratio of operating income to total revenue.

[6] Ratio of non-operating income to total revenue.

[7] Ratio of current assets to current liabilities.

[8] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[9] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[10] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[11] Ratio of total income plus interest expense plus depreciation and amortization to interest expense plus current portion of long-term debt.

[12] Ratio of total income plus depreciation and amortization to total current liabilities plus total long-term debt.

[13] Ratio of total net assets to total assets.

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